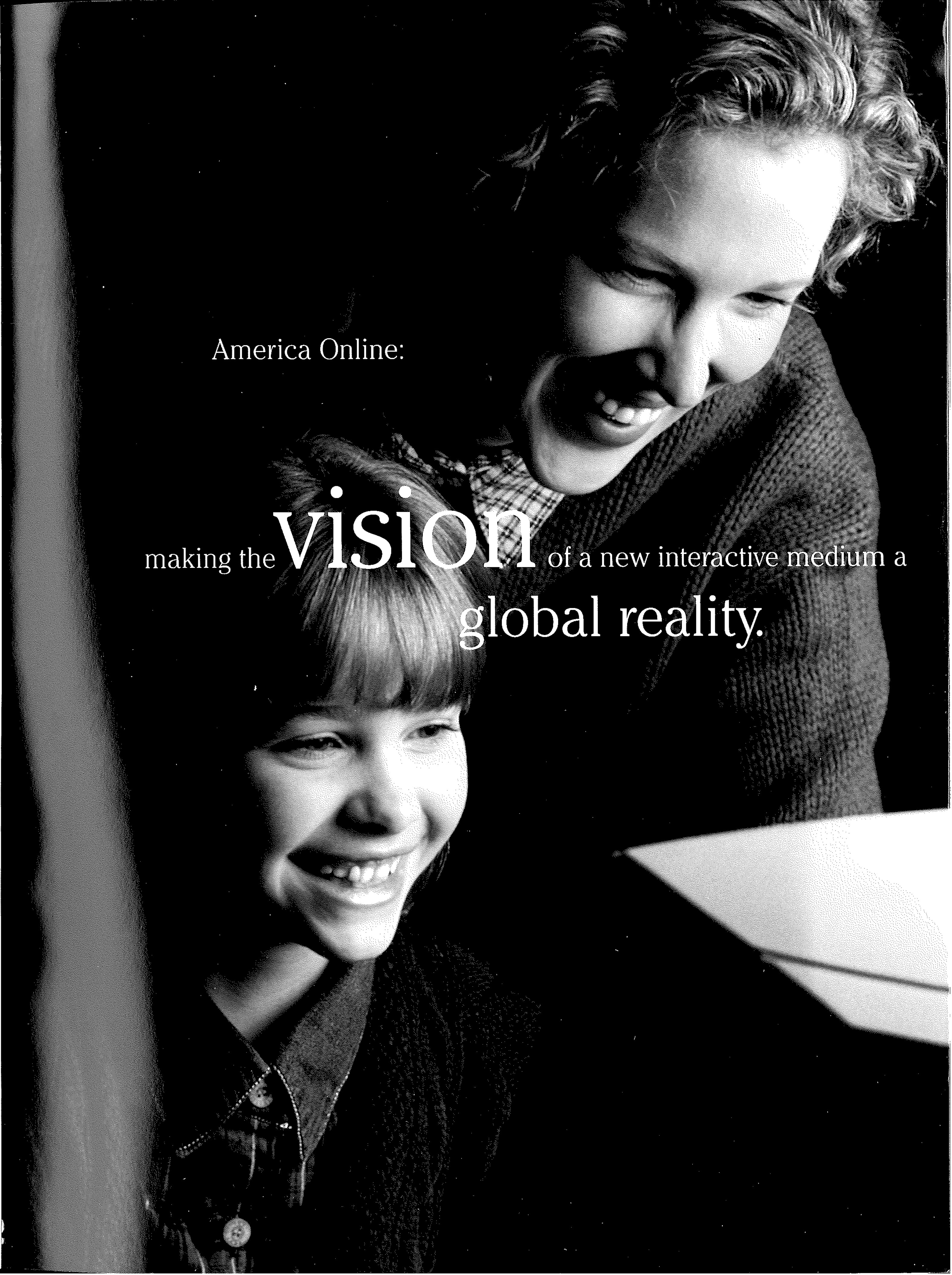
"Welcome"

to America Online, Inc.

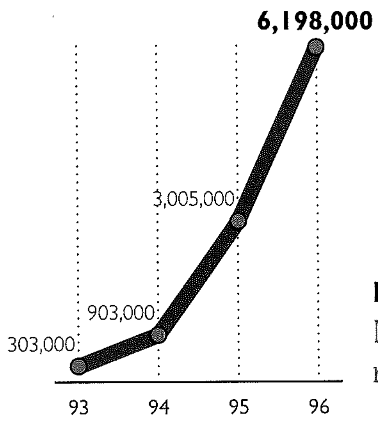
annual1996@aol.com

Founded in 1985, America Online, Inc. (NYSE: AOL) has pioneered the building of a new interactive medium, one that transcends traditional boundaries between people and places to create a new global community.

As the worldwide leader in a new medium, America Online is also the first billion-dollar company in the industry. The Company has the greatest subscriber base, operates what we believe is the largest private high-speed dial-up network in the world, creates the most interactive content in the industry, has formed alliances and furthered efforts to offer electronic consumer services in five countries, provides electronic access via hundreds of locations worldwide, and has more than 5,300 employees around the world. America Online, which is based in Dulles, Virginia, more than doubled the number of subscribers in fiscal year 1996 and as of June 30, 1996 had more than 6 million members worldwide.


America Online:
making the vision of a new interactive medium a global reality.

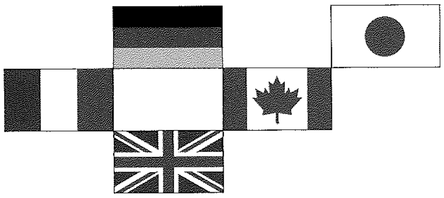
What's new...



Membership Growth
More than doubled membership in a year; reaching almost 6.2 million members worldwide.

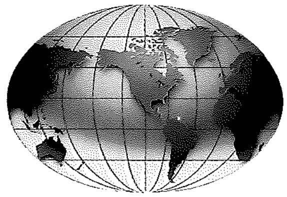
Unparalleled Customer Support in the Industry
Grew from 1,800 to 3,200 customer support representatives in one year.

International Services
Launched AOL services in France, Germany, the United Kingdom and Canada; announced joint venture to introduce service in Japan.



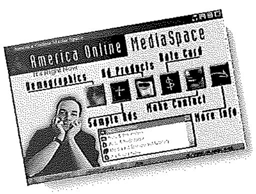
Building Alliances
Leveraged the hottest technology and achieved strategic tour de force through alliances with Apple, Microsoft, Netscape, Sun Microsystems, and AT&T – all announced in one month.

Microsoft NETSCAPE Sun microsystems AT&T



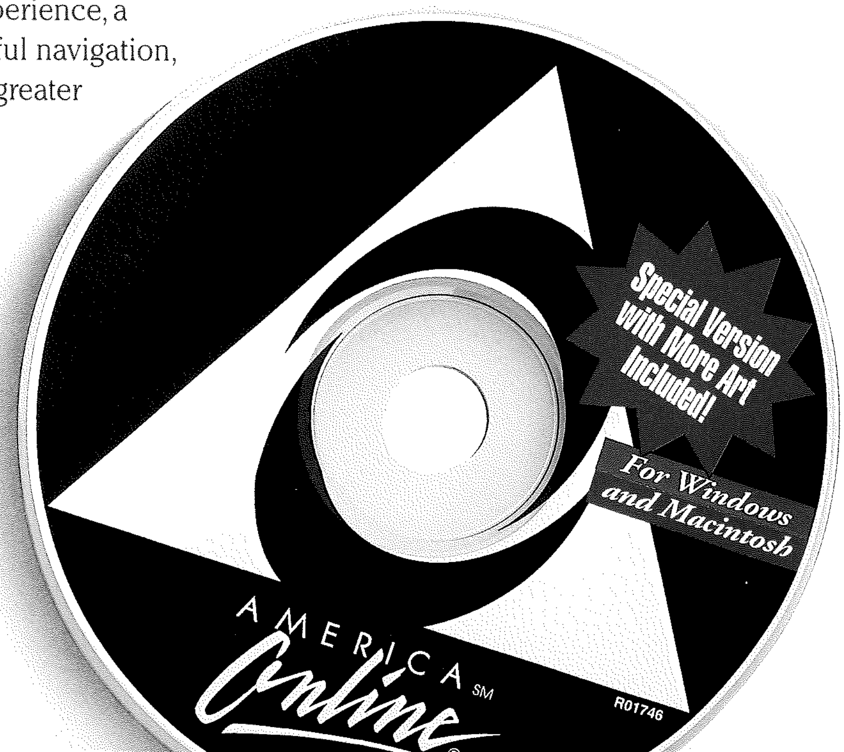
Growing the Network Worldwide
Built network from 20,000 modems to more than 140,000 modems; increased points of presence to 470 cities and 650 phone numbers; operate what we believe is the largest private high-speed dial-up network in the world.

New Revenue Streams
Our new dynamic, customized advertising program delivers both a guaranteed and a targeted audience. Pricing is based on the industry standard "cost per thousand" metric ("CPM"). We calculate our CPM figures by measuring actual page views, rather than by estimating potential audience exposure to a message.

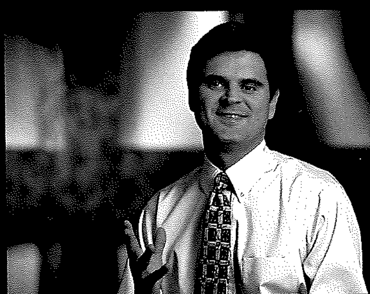


Original Content
Made significant progress in original content with new channels – launched first AOL generated content areas – the Style Channel, Thrive, The Hub, Digital City, International, Games, and Love@AOL.

The New AOL
Launched AOL 3.0, giving consumers a faster and more convenient online experience, a better Web browser, more powerful navigation, enhanced communication, and greater personalization capabilities.



"AOL is now among the largest 'cities' in the



world; more people live in the AOL community than in the metro areas of San Francisco, Madrid, or Sydney."

– Steve Case, February 1996

Dear Stockholder,

What an incredible year. In a complex and dynamic market, we focused on what consumers wanted and it was a winning strategy.

We doubled our membership to more than 6,000,000, as more consumers flocked to AOL's unique easy-to-use, affordable blend of content, context and community. As a result, our revenues surged to more than $1 billion – nearly tripling over the past year. Despite the investments we made to grow rapidly, we also grew profitably; in the most recent quarter, for example, we set new records for gross profit margins and earnings-per-share from operations.

But we didn't stop there. We made significant strides in positioning the company to be the global leader in interactive services. We expanded globally, through a successful launch in Europe. We launched locally, through the creation of Digital Cities. We grew our portfolio of new content brands, partnering with small entrepreneurs and large media companies. We extended initiatives to build new revenue streams from advertising, transactions, and new distribution channels – revenue streams that we expect will significantly drive future profitability. We beefed up our AOLnet data network to reduce costs and position us to grow rapidly and exploit new opportunities such as Internet telephony. We expanded our team and now have more than 5,300 people dedicated to bringing the magic of interactive services to tens of millions of people worldwide.

For more than a decade, we've led the industry – first as the tiny upstart with some better ideas, and more recently as the market leader with a passion about the possibilities of this new interactive medium and a conviction that tens of millions of people can benefit from what AOL has to offer. Over the past decade, we've seen considerable change, as many competitors and technologies have come and gone. Our overarching focus on meeting the needs of consumers enables us to withstand – indeed, prosper – in the face of this competition and confusion.

But now we enter a new phase for this industry, and for our company. The pace of innovation is quickening, as Internet technologies evolve and a flood of new companies attempt to get a piece of the action. We believe we are uniquely positioned to capitalize on this opportunity, but we recognize that we must constantly reshape our company to cement our position of global leadership.

We are making great strides in the area we care most about: providing consumers with a superior interactive experience that can enhance the way they get information, communicate with others, buy products and learn new things. We continued to extend the uniqueness of the AOL experience with the launch of a new version 3.0 which gives our members a faster and more convenient online experience, easier navigation, enhanced communication, and new features that empower members to personalize the service. These new tools enable members to see when their friends are online, shape features and preferences in ways never possible before, create their own Web page in seconds, and enjoy one-click access to any favorite places on the AOL service and the Internet. But the "new AOL" is not just about new software – we've also redesigned the service to make it easier to use, adding powerful new tools such as a

Despite all the progress we made over the past year, we aren't resting on our laurels. We are redoubling our efforts to solidify our position as the global leader in interactive services.

universal "Find" feature that enables members to quickly identify and reach areas that interest them. And we've deployed a new plug and play architecture which allows us to add new innovations on the fly. As a result, members will soon benefit from new features such as real-time audio and video, as well as the much-awaited launch of "AOL Phone" which will enable members to talk to each other using their own voices.

We have taken steps to re-establish AOL as the value leader in the consumer market. Our low $9.95 monthly fee continues to be attractive to the mainstream consumer audience we're targeting, but we recently added a $19.95 "Value Plan" that has been well received by our heavier users as well as by families worried about running up big bills. Price will continue to be an important competitive factor, so we have been testing a wide variety of alternatives. But we realize delivering a superior value does not necessarily mean having the lowest price, so we continue to invest in ways to make AOL different and better. Our large audience makes this possible, as we are able to provide free access to premium content that carries a surcharge elsewhere. The larger we get, the better we get.

We have embraced the Internet – and improved on it. There is no question about the importance of the Internet, and the role it will play in the future. Over the past year, we have emerged as the leading way consumers connect to the Internet. Nevertheless, we recognized that our Internet experience wasn't all it could be, so we've focused on integrating "best of breed" technologies (from Microsoft, Netscape, Sun, Macromedia and others) to make them really easy to use, and then adding to that mix our own unique technologies – such as compression that makes the Web much more usable for people with typical modems – to provide a differentiated Internet experience. For example, given that people are often frustrated by the slowness of accessing pages on the World Wide Web, we bought the company with the industry's best compression technology, so we are uniquely positioned to provide consumers with a faster Web experience. Additionally, we have expanded the ability of our members to publish directly on the Web, added one-click hyperlink tools for email and personal folders, and launched Virtual Places, which we consider to be the most sophisticated community-building tool on the Web.

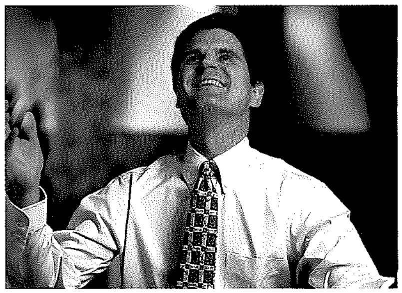
We are providing the Internet – and a whole lot more. The first step was to make sure our Internet access and technologies were superior to competitive offerings, and we believe we have done that. But we aren't stopping there. We are also adding editorial value, by making it easier for AOL members to find quality content of interest to them, and we're leveraging our buying power to provide free access to content that carries a surcharge for customers of other services. We're also creating a wide array of interactive experiences that are exclusive to AOL; for example, the innovations we're adding in the areas of context, community and convenience help set us apart from the pack. "My AOL" brings together a wide array of personalization tools, enabling members to quickly set up their own stock portfolio, news clipping service, address book, and control what services their children are allowed to see. "Buddy Lists" alert members when their friends and relatives are on AOL, so they can communicate with them in real-time. The power of our "Instant Message" feature will soon be enhanced with the addition of "AOL Phone."

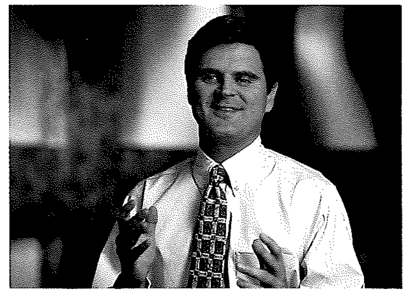
We are gearing up to "relaunch" AOL with a more strategic marketing focus. We have had great success with our marketing efforts centered around making it easy to try AOL by broadly distributing free AOL software. That effort will continue; indeed, it will be expanded, as we have signed agreements to get AOL software pre-installed with Windows95 and Macintosh computers. But as we reach out to the unserved 89% of U.S. households, we recognize we need to do more. Our new advertising campaign will focus on differentiation – explaining, for example, how AOL is "the Internet and a whole lot more." And when consumers try AOL, we will have a welcome wagon waiting, eager to ascertain their interests and suggest relevant content. But this

is not just about reaching new customers; we will step up our efforts to reach out to our existing 6 million members. We want to make sure they are getting the most out of AOL, and will therefore see the benefit of remaining a member of AOL for many years to come.

We are increasingly leveraging our distribution footprint. With 6 million members now and a goal to reach 10 million members in 1997, our size gives us a significant strategic advantage. As more Web sites recognize that they cannot be profitable without advertising, and can't generate significant advertising revenues without reaching a large audience, and cannot quickly and efficiently reach a large audience on their own, we expect a growing number of them to rush to align with AOL. These companies need our help in aggregating an audience, and we can leverage our distribution footprint to do that. This promotional power will also enable us to build new content brands such as Digital Cities, our local brand which we are developing in partnership with Tribune Company, and Imagination Network, our multi-player game service; our joint ventures with media companies such as Time Inc. (Thrive) and Disney's Cap. Cities/ABC (Style); and our innovative Greenhouse initiatives, such as The Motley Fool. The media brands of the future are increasingly being nurtured on AOL, and we believe our mounting promotional power will enable us to build these brands into cyberspace hits.

We are focused on evolving new business models and accelerating the creation of new revenue streams. We believe the online business will evolve like other consumer media businesses, which means success will accrue to the companies with the largest audiences, as they will be able to leverage that audience reach to generate significant revenues and profits. Accordingly, we are rapidly growing revenues from advertising and transaction fees. Our advertising sales are now exceeding those of our online competitors combined. Our new Interactive Marketing division is already the industry leader in transactional revenues. We are also expanding our enterprise initiatives, to resell daytime network capacity and to build "private AOLs" for corporations. AOLnet has grown from 20,000 modems last year to





become what we believe is the largest private high-speed dial-up network in the world, with more than 140,000 modems deployed in nearly 500 cities. We are reselling this network to businesses, and bundling total solutions by creating private AOLs. Soon, the promise of Internet telephony will make this network infrastructure even more valuable to the company and its members. Together, the development of these alternative sources of revenues (advertising, transactions, and business-to-business services) will enable us to continue to improve the AOL value proposition, while also enhancing shareholder returns.

We are establishing the best-known brand in cyberspace, in the United States and throughout the world. AOL is far and away the leader in terms of consumer recognition and intention to buy within our core U.S. market. Recognizing that the playing field for interactive services doesn't stop at national borders, we are rapidly expanding our global presence. Our joint venture in Europe with Bertelsmann is off to a great start. This past year, we launched AOL in Germany, France, and the United Kingdom and we already have more than 200,000 members; by comparison, it took us 7 years to get to 200,000 members in the United States. We launched a more localized version of AOL in Canada and believe we are well positioned to

become the leading Canadian service in 1997. We recently entered into a joint venture with Mitsui and Nikkei and are gearing up to launch AOL in Japan in 1997.

We are taking the lead in defining the ground rules for this new medium. Key policy issues will greatly influence the ultimate shape of this emerging medium. AOL led the industry by developing a coalition that successfully challenged the Communications Decency Act as unconstitutionally vague. We initiated widespread efforts to make interactive services available in our nation's neediest schools. AOL leadership spanned a broad range of issues, and we plan to continue to take the lead to ensure that this emerging medium brings the maximum benefit to our society, particularly in terms of supporting the economically and socially disadvantaged, providing safety and security as well as educational opportunity for our children, and enhancing the ability of people to communicate freely and openly.

By constantly remaking itself, we believe AOL will maintain its position of global leadership in the dynamic marketplace. Despite our considerable recent success, rising over the past two years from #3 in our market to #1 and from having just 1 million members to reaching more than 6 million, we realize there is still a long way to go to achieve our objectives – and there are a growing array of competitive forces standing in our way. So we have initiated a series of significant changes designed to reshape our company and to keep us out in front as a leader of the dynamic marketplace for years to come.

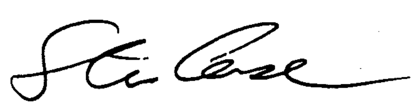
As always, our focus will be centered on meeting the needs of consumers. A superior interactive experience will continue to be our "raison d'etre." For more than a decade we've assembled capabilities, features and content that we believe no one else can match, and as we roll out the "new AOL" this Fall, it will be quickly apparent that we have improved on that score. The new AOL will offer the best Internet access, but also a whole lot more, including a wide range of features that are unique to AOL. We will provide our members with an online Internet experience that includes the fastest, easiest, most exciting and most useful functions, features and content for the best consumer value.

We believe audience reach will become increasingly important, and that's why we'll continue to invest heavily in expanding our distribution footprint, with the goal of reaching 10 million members in 1997. We believe this will give us unparalleled buying power for our members, enabling us to provide them with an ever-expanding array of new features at no additional cost. It will provide exceptional opportunities for companies eager to market to this large and lucrative audience, and the resulting new revenues will be an increasingly important source of revenue and profit. And it will give us an unmatched ability to launch new content brands in cyberspace. We believe our global distribution leverage and promotional clout will become increasingly important as brands proliferate and consumers face a daunting set of choices. With 6 million members, we are already beginning to see the leverage that our global audience reach provides; as we head towards 10 million, we believe our competitive advantage will increase.

Despite the progress our industry has made in recent years, only 1 out of 10 U.S. households subscribes to any online service. As we reach out to the unserved market, we recognize that we must constantly raise the bar so we can provide an ever-widening audience with an engaging interactive experience that greatly changes and enhances the lives of millions of people.

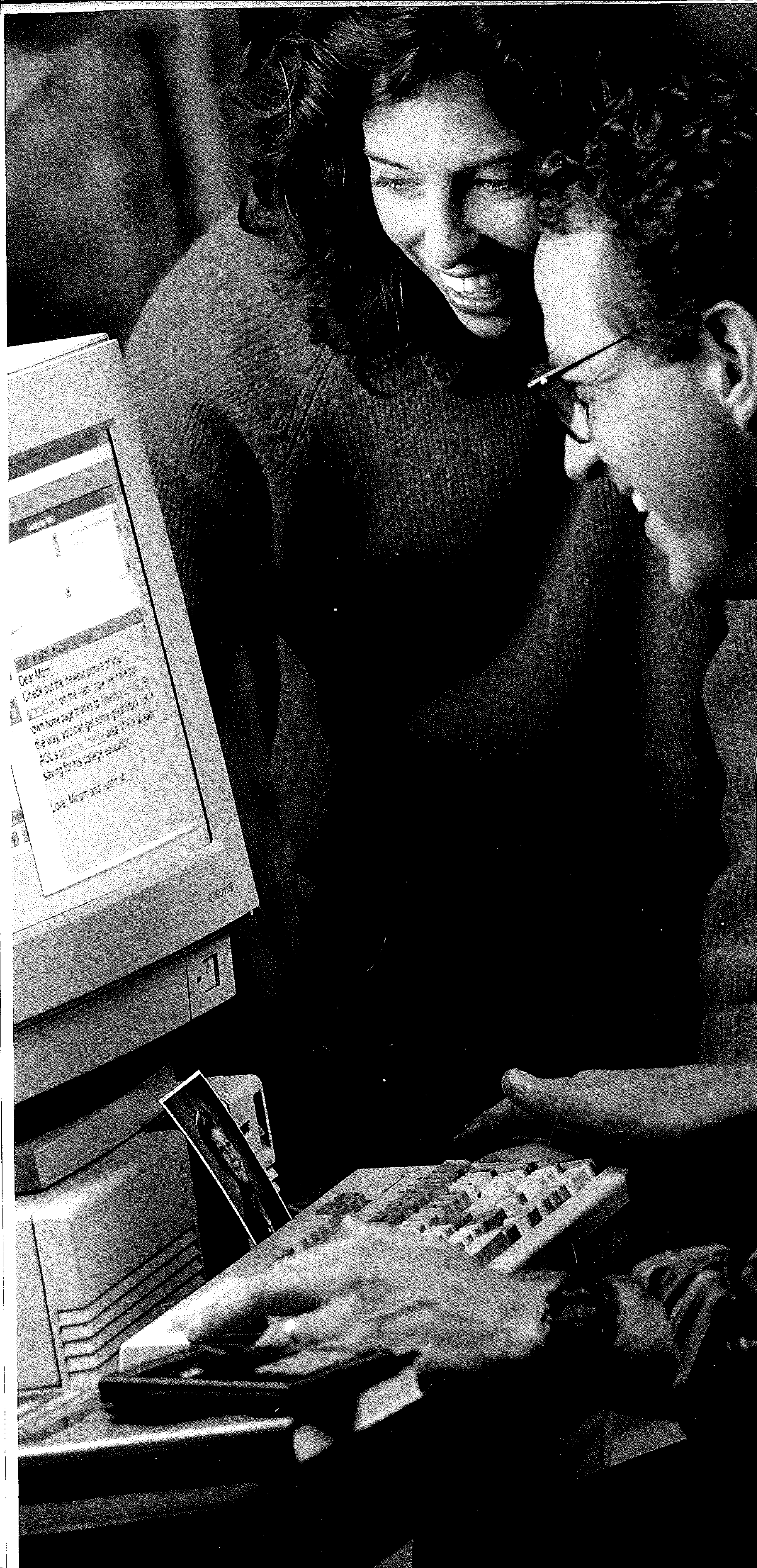
With a renewed sense of focus and passion, AOL is well positioned to lead the charge towards embracing a mainstream audience – and that's precisely what we intend to do.

Sincerely,



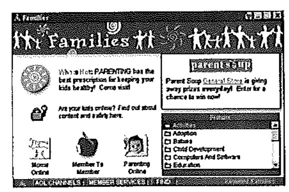
Stephen M. Case
CEO and Chairman of the Board

We focus all of our creative attention on what we must do to maintain our leadership position in global interactive services. What follows epitomizes our accomplishments over the past year and our vision for the future.



AOL and the Family

Health, development, education, entertainment, and finances are only some of the topics concerning families. In AOL's Families Area, members



explore these issues together as an interactive community. "Parent Soup," created from a partnership between America Online and iVillage, offers forums designed to let parents nationwide exchange experiences and stories. Mothers have their own special section in "Moms Online," a Greenhouse production offering motherly advice on child-rearing. More and more consumers are recognizing that AOL is a remarkable family service, and we're responding with better family content than can be found anywhere else online.

Delivering the best consumer experience.

More than a decade ago we began building this medium. The first graphical user interface – easing navigation and making interactive services more engaging. The first simple, affordable pricing. The first online communities that personalized the experience. The first interactive programming.

Today, no one understands what consumers want from their online experience better than America Online – and no one does a better job of delivering it. Every day, our intense focus on a faster, more useful and enjoyable online experience pays off in more members, richer communities, more seamless technology, better customer service and more fun, useful content.

We work hard to ensure that each individual experience with AOL is a gratifying one – a confirmation that AOL is the right choice. From the loading of new software, to the first click of the mouse, or a call to customer support, we want our members to be more than just satisfied. We want them to be delighted.

"The New AOL" makes it easier to achieve that goal. Our new software removes the blue "art download" bar, gives members more speed and control on the service and the Web, makes navigation and email more powerful with fewer clicks, improves access to chat and private rooms for family and community gatherings, and makes exciting multi-media content available at low bandwidths.

We have established "customer loyalty labs" across the membership base, testing new and innovative approaches to increasing member satisfaction and enhancing member retention. We've cut the time it takes to reach customer support to the shortest in the industry by adding thousands of highly trained member services personnel.

The bottom line: the happier our members are, the more time they'll spend online, the longer they'll stay with the service and the more friends and associates they'll ask to join them on AOL.

All users, female: 41%

All users, male: 59%

Report other user(s) in household: 56%

Spouses who use the service: 42%

Households who have children: AOL: 46% vs. U.S. Census: 35%

Users with children (ages 6-17) in household: 54%

College graduates: AOL: 63% vs. U.S. Census: 23%

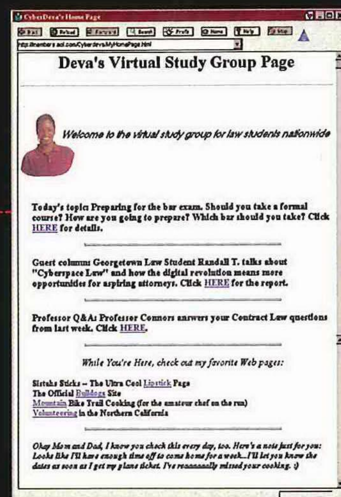
Use service for both personal and business use: 41%

Favorite Places

Member Profile

Screen Name: CyberDeva
Member Name: Deva
Location: Palo Alto, CA
Birthdate: April 14
Sex: Female
Marital Status: Single
Computers: 486 AND a Mac
Hobbies: Mountain Biking, Surfing the Net, Community Theatre, Volunteering
Occupation: 3rd Year, Stanford Law
Personal Quote: "Above all, to thine own self be true." –Shakespeare. "And while you're being true to thineownself, thee might as well have a chocolate chip cookie." – CyberDeva

Personal Web Page



Stock Portfolios, News Profiles

Buddy Lists

Find Tool

Technology – keeping it simple, making the magic.

Advances in technology are happening at a dizzying pace. Even the buzz words labeling the core technologies that contribute to the phenomenon of the Internet are complex – Java applets, Shockwave, TCP/IP – and somewhat daunting to the average consumer. Our philosophy is to give consumers all of the benefits with none of the confusion; so, since founding the company in 1985, we have leveraged a flexible, scalable architecture that enables us to rapidly embrace new standards and technologies as they emerge, and integrate them into AOL in a seamless fashion on behalf of the consumer.

Indeed, we believe the transparency of the technology behind our service is part of what sets AOL apart from the pack. The technology is working invisibly in the background to enable services that can be accessed more quickly, delivered in a more engaging fashion with the latest in sound and graphics capabilities, and personalized and customized to meet individual needs. AOLnet delivers these services over the largest TCP/IP dial-up network in the world.

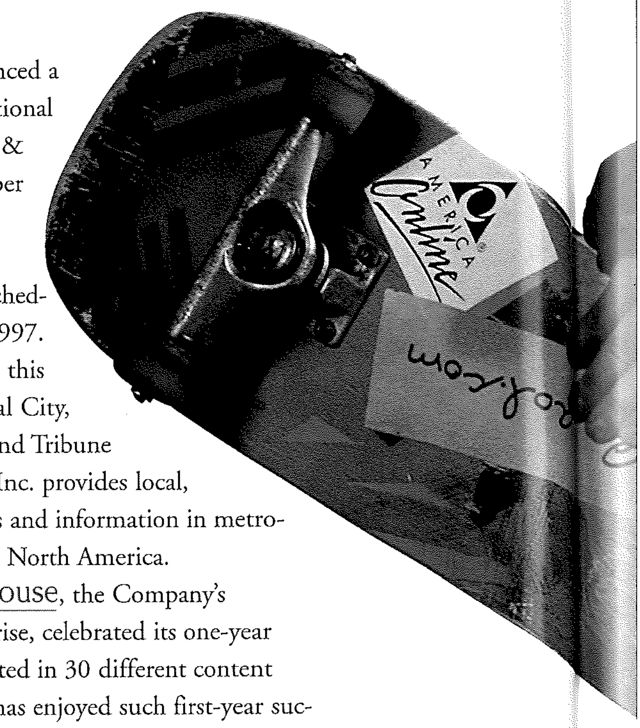
We leverage the best that the market has to offer – whether generated in or outside of AOL. On the browser front, for instance, we've struck partnerships with both Microsoft and Netscape, to ensure our members have the latest in industry-leading browser capabilities. Macromedia's Shockwave and Sun Microsystem's Java technologies will enhance our members Internet experience through AOL. By combining our own technologies with those partnerships we are building an experience for our members that they simply won't get anywhere else using regular modems – streaming audio and video, slide shows and a variety of other features that are as fast, useful and convenient as they are fun and exciting to use.

The fact is, the "everyday" AOL experience often represents some of our most impressive and differentiating technological advancements. The speed and reliability of our Web experience is unmatched by our competition. The scale and functionality of our "chat", in which tens of thousands of individuals come together and communicate in real time, exists exclusively on AOL. Personalized "buddy lists" – knowing which of your friends are online while you are – involves a complex server technology that tracks millions of consumer sessions simultaneously. You can create a Web page in 60 seconds on AOL. Each of these are classic examples of simple features our members take for granted. In "The Wizard of Oz" the magic was the man behind the curtain; here at AOL the real man behind the curtain is our technology – invisible, totally transparent, unheralded, but world class and supporting everything we do.

Technological Advancements

Members create their own Web page in seconds with powerful Web publishing tools. They design multiple stock portfolios. They program personal news profiles, delivered straight to their emailbox. They designate favorite places online to store in a special folder. They join new communities created through new areas and channels. They surf all of cyberspace seamlessly with ease and power. They share all of these online discoveries through hyperlinks in correspondence. We give communities the tools they need to shape their own online destinies.

The number one brand in cyberspace.



In a world of confusing choices, brand leadership drives the market. America Online has the strongest brand in the interactive services marketplace.

Today, when a consumer thinks about going online for the first time, more often than not, America Online is the service considered first. When a Senator wants an answer to a question about online policy, America Online gets a call. When an analyst is checking out a new theory on the future of the interactive medium, America Online is asked for its perspective. When a technology company looks for a market for new interactive tools it has developed, America Online receives the sales pitch. When a publisher or programmer seeks a strategic partner for an interactive initiative, they contact America Online.

That's the way we want it to stay.

Now, in addition to fortifying the AOL flagship service brand, the company is leveraging its brand strength to create new ventures – new companies that will both retain the benefits of AOL's worldwide reputation and build strong identities of their own.

In Europe, we built a 50 percent partnership with publishing powerhouse Bertelsmann, which has already launched three independent services: AOL France, AOL United Kingdom and AOL Germany.

In Canada, our newly launched service is poised to become the premiere online service by year's end.

In Japan, we announced a partnership with international trading company Mitsui & Co. and leading newspaper publisher Nihon Keizai Shimbun, Inc. (Nikkei). The Japanese service is scheduled to be launched in 1997.

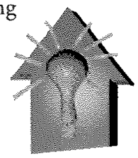
In the United States this year, we launched Digital City, owned jointly by AOL and Tribune Company. Digital City, Inc. provides local, interactive content, news and information in metropolitan areas throughout North America.

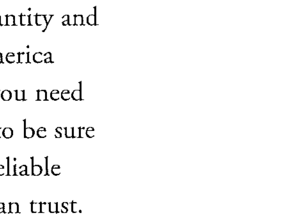
The AOL Greenhouse, the Company's in-house content enterprise, celebrated its one-year anniversary having invested in 30 different content properties. Greenhouse has enjoyed such first-year successes as The Motley Fool, Hecklers Online, Astronet, Health Responsibility Systems, Extreme Fans, iGolf, Love@AOL and Moms Online.

We will continue to aggressively build and extend our brands. Our brand familiarity will provide reassurance that cuts through the quantity and the confusion – the names America Online and AOL are all that you need to remember when you want to be sure you're getting the best, most reliable service from a company you can trust.

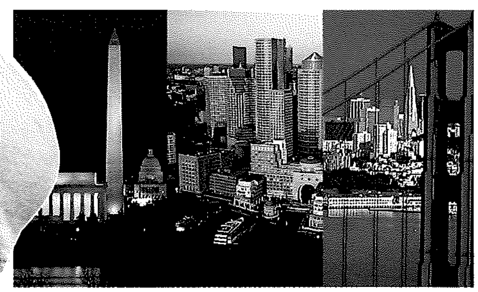
The Greenhouse Grows Roots:

The AOL Greenhouse has gone Hollywood. We're producing new kinds of entertainment properties, we're buying and developing intellectual properties and joint ventures – and we're branding new and exciting in-house "cyber-hits."

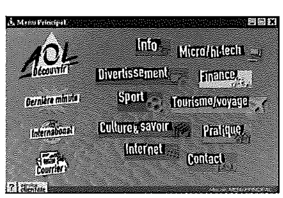


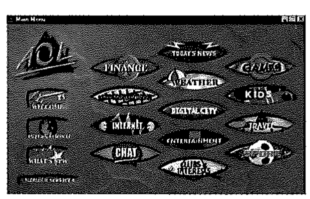


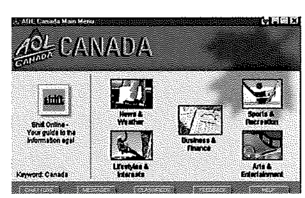
Digital City First launched in 1995 as an extension of AOL's community-centric focus, local Digital City affiliates are currently operating in Washington, D.C., Boston and San Francisco, with plans to expand to over 40 cities in years to come. Digital City provides AOL members instant access to information such as fast-breaking local news, weather, sports, and traffic conditions.



Germany, France, UK and Canada...with Japan coming soon! Because the key attributes we want associated with the global brand are community, ease of use and personalization, we have built each of these international services from the ground up, featuring local content and culture in corresponding languages.







The best in interactive programming – only at AOL.

It seems absurd now, but the early years of television showed people crowded around microphones reading scripts as if they were on radio. Viewers didn't complain, because the novelty of television was so intriguing. What really made television? Programming that took advantage of the new medium's visual power.

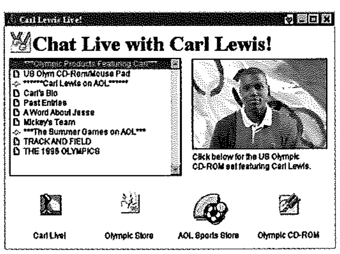
Just like television, interactive services must take advantage of our competencies to drive our medium into the mainstream. We intend to fully exploit the nature of the medium itself – with unique programming created from significant investments in original content. This is not about just "repurposing" content from the other media. We want to create new content relevant for the medium and meaningful for the future.

America Online is quickly positioning itself as a catalyst of innovation. While many in the on-line world may be in lockstep with the reading-the-radio-script stage, we've built an interactive programming business, with a studio system that creates and combines original content and features that have enabled us to jump to the top of the industry. The most creative minds and the best entrepreneurs today are focusing on building previously unimagined services that can have broad appeal.

Each click should give our members an experience that transcends what is merely satisfying and becomes something that is truly exceptional.

The AOL Programming Strategy

- Aggressively promote interactivity
- Host scheduled chats
- Make stars of our members
- Use a personal touch
- Program with the new member in mind
- Assert a point of view
- Create an editorial calendar
- Keep the content fresh
- Respond to real-world events
- Above all, create passionate, loyal followings for online areas



The names you know are on AOL

Exclusive AOL programming such as the Olympic journals and live chat events with athlete Carl Lewis increase AOL's value and relevance to our members.

Schedule of Shows

August 28, 1996

2:00pm ET "The Cranberries", currently in the middle of "the Faithful Departed" tour, are one of the hottest bands out of Ireland and will be live to answer your questions.

5:30pm ET Hootie & The Blowfish LIVE from their pre-concert soundcheck in Tampa, Florida.

8:00pm ET James O'Shaughnessy, investment advisor and author of "What Works on Wall Street" will be live on AOL. Don't miss this strategy session.

10:00pm ET John Landis, Director of blockbusters such as "National Lampoon's Animal House", "The Blues Brothers", and "Trading Places" joins Oldsmobile and AOL Live.

10:00pm ET NetNoir welcomes Author CHRIS FARLEY, as he discusses his new book, My Favorite War. Keyword: NetNoir.

Introducing the AOL Visa Card:
6.9% Fixed Introductory APR! No Annual Fee! Earn FREE AOL Time.

1-800-Flowers
It's the week before Mothers Day, 1996. 1-800-Flowers' Web site does 500 sales. Respectable. In AOL's Marketplace, the same company does 30,000 sales in the same time period. Remarkable.

And our pledge is this: "Your satisfaction is guaranteed when you purchase goods or services on AOL. If at any time you are not satisfied with a product or service you receive from an AOL Certified Merchant just contact us… and we'll make it right. We'll help you with the merchant, or intervene on your behalf – whatever it takes to make it right. Shopping on AOL is shopping the way it should be."

New business models at work.

Compare AOL membership to cable subscriber households and we place third, after giants TCI and Time-Warner. Compare us to the top dailies and you'll find more people have "subscriptions" to AOL than to The Wall Street Journal, New York Times, USA Today, and Los Angeles Times combined. This subscriber base of more than 6 million households translates into a total of more than 10 million individual customers.

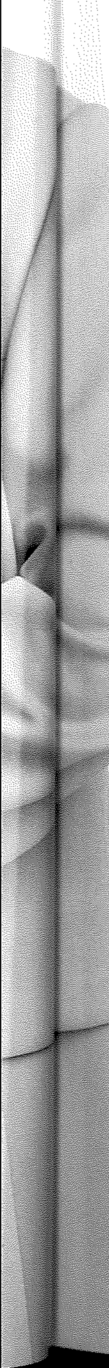
It's a fact that America Online members account for a third of all consumer travelers on the Internet – making AOL the largest Internet community by far.

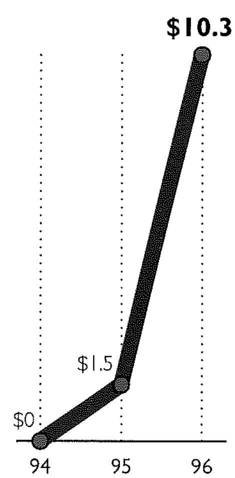
We think that advertisers, media buyers and merchandisers won't miss the significance of these numbers; they also understand the purchasing power that underlies the AOL community.

We can bolster ad buys by tracking the number of entries to AOL screens, as well as the total number of visits, or sessions, to an online area. AOL can also track how many member hours are spent in an area, the average minutes per visit, and trends in member navigation, all while maintaining our high standard of protecting member privacy and ensuring a rich online experience.

Our Marketplace has grown into the online equivalent of a personalized shopping mall. As dozens of brands establish their presence in the mall, consumer traffic increases, and sales volume expands.

Promising trends for additional sources of alternate revenues come from our AOL Enterprise and ANS businesses. AOL Enterprise offers businesses intranet capabilities that combine the simplicity of America Online, the features and functionality of groupware and the breadth of the Internet in a unique solution we call a Private AOL. ANS, with the largest TCP/IP network in the world, offers state-of-the-art solutions for company wide-area TCP/IP networking needs. ANS, now headed by a world-class executive from British Telecom, not only created the cornerstone of AOLnet, but is managing network deployment for AOL United Kingdom and AOL France.





AOL Advertising and Transactions Revenue
(dollars in millions)

Transactions Happen

More and more consumers are conducting transactions online...and especially on AOL. They find trusted brands such Eddie Bauer and JC Penney; AOL branded merchandise in the AOL online store; brokerage and travel services through our joint ventures with partners such as PCFN and Preview Travel; and free online time through use of our co-branded AOL Visa card. Our own Marketplace Gift Valet service is yet another way we add value by personalizing the shopping experience for our members. Our goal? To make online shopping a valued convenience for our members, saving them time, money – or both!

The Future.
Now Available...

A Message from Steve Case, Chairman and CEO of America Online, Inc. and a Brief Demonstration of AOL's Internet Adventure...

Use this special registration number and password for your free trial:

Registration Number: 3A-7740-2703
Password: strati-bins

The AOL Annual Report '96 CD-ROM System Requirements

Windows 3.1

- 80386DX-33 processor
- Minimum 4MB of RAM
- 300K CD-ROM drive
- Windows compatible audio card
- 5 MB hard disk space available
- VGA monitor (640x480, 256 colors)
- Mouse
- DOS 6.0 or higher
- Video for Windows 1.1 (CD-ROM could install it)
- 2400 - bps modem

Windows 95

- 80486DX-33 processor
- Minimum 8MB of RAM
- 300K CD-ROM drive
- Windows compatible audio card
- 5 MB hard disk space available
- VGA monitor (640x480, 256 colors)
- Mouse
- DOS 6.0 or higher
- Video for Windows 1.1 (CD-ROM could install it)
- 2400 - bps modem

Selected Consolidated Financial and Other Data

(Amounts in thousands, except per share data)	Year ended June 30, 1996	1995	1994	1993	1992
Statement of Operations Data:					
Online service revenues	**$ 991,656**	$ 344,309	$ 98,497	$37,648	$26,095
Other revenues	**102,198**	49,981	17,225	14,336	12,658
Total revenues	**1,093,854**	394,290	115,722	51,984	38,753
Income (loss) from operations	**65,243**	(21,449)	4,176	1,702	3,685
Income (loss) before extraordinary item	**29,816**	(35,751)	2,154	246	2,344
Net income (loss)[1]	**29,816**	(35,751)	2,154	1,379	3,768
Income (loss) per common share:					
Income (loss) before extraordinary item	**$ 0.28**	$ (0.51)	$ 0.03	$ –	$ 0.05
Net income (loss)	**$ 0.28**	$ (0.51)	$ 0.03	$ 0.02	$ 0.08
Weighted average shares outstanding	**108,097**	69,550	69,035	58,572	45,656

	As of June 30, 1996	1995	1994	1993	1992
Balance Sheet Data:					
Working capital (deficiency)	**$ (19,328)**	$ 271	$ 38,679	$10,498	$12,363
Total assets	**958,754**	405,413	155,178	39,279	31,144
Total debt	**22,519**	21,856	9,341	2,959	2,672
Stockholders' equity	**512,502**	216,812	98,802	23,785	21,611
Other Data (at fiscal year end):					
Worldwide subscribers	**6,198**	3,005	903	303	182

[1] Net income in the fiscal year ended June 30, 1996, includes charges of approximately $17.0 million for acquired research and development, $8.0 million for the settlement of a class action lawsuit, and $0.8 million for merger expenses. Net loss in the fiscal year ended June 30, 1995, includes charges of approximately $50.3 million for acquired research and development and $2.2 million for merger expenses.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company has experienced a significant increase in revenues over the past three fiscal years. The higher revenues have been produced principally by increases in the Company's subscriber base resulting from growth of the online services market, aggressive subscriber acquisition marketing and the expansion of its services and content. Additionally, revenues have increased as the average monthly revenue per subscriber has risen during the past three years, primarily as a result of an increase in the average monthly number of paid hours of use per subscriber.

The Company's online service revenues are generated primarily from subscribers paying a monthly membership fee and hourly charges based on usage in excess of the number of hours of usage provided as part of the monthly fee. Through December 31, 1994, the Company's standard monthly membership fee for its AOL service, which includes five hours of service, was $9.95, with a $3.50 hourly fee for usage in excess of five hours per month. Effective January 1, 1995, the hourly fee for usage in excess of five hours per month decreased from $3.50 to $2.95, while the monthly membership fee remained unchanged at $9.95.

In May 1996, the Company announced an additional pricing plan for its AOL service to improve retention among its heavier users. The new pricing plan (the "Value Plan"), which became effective July 1, 1996, includes 20 hours of service for $19.95 per month, with a $2.95 hourly fee for usage in excess of 20 hours per month. The Company expects that the Value Plan will result in an increased number of hours of usage relative to revenues.

In October 1995, the Company launched its Internet service, Global Network Navigator ("GNN"). The GNN service is aimed at the segment of online consumers who seek a full-featured Internet-based service. The current standard monthly membership fee for GNN, which includes 20 hours of service, is $14.95, with a $1.95 hourly fee for usage in excess of 20 hours per month.

The Company's other revenues are generated primarily from the sale of merchandise, data network services, online transactions and advertising, marketing and production services and development and licensing fees. The growth of other revenues is important to the Company's business objectives. In fiscal 1996, other revenues represented approximately 9% of total revenues. Among the Company's business objectives are increasing the subscriber base and changing its business model over time into one in which more revenues and profits are generated from sources other than online service revenues, such as merchandise sales, advertising, the provision of data network services and transaction fees. The Company expects that the growth in other revenues, which generally carry higher margins than online service revenues, will provide the Company with the opportunity and flexibility to fund programs designed to grow the subscriber base. If the growth in other revenues does not materialize to the extent the Company expects, there can be no assurance that the Company will be able to meet its business objectives.

In the near term the Company's revenue growth will continue to be driven primarily by growth in its subscriber base. The growth of the subscriber base is dependent upon the Company's ability to acquire and retain subscribers.

The Company acquires new subscribers to its services through an introductory trial offer. The Company's ability to continue to acquire new subscribers is dependent upon people continuing to register for its introductory trial offer.

In fiscal 1997, the Company plans to spend more than in previous years on subscriber acquisition marketing, and expects that the balance of deferred subscriber acquisition costs will increase by an amount comparable to the increase during fiscal 1996. In addition, the Company anticipates lower direct response

rates, and as a result, cost per registration for the AOL service is expected to increase. The Company expects that the increased cost per registration resulting from lower direct response rates will be partially offset by lower cost registrations generated by bundling relationships with Microsoft, Apple, AT&T and others, as well as increased word-of-mouth acquisitions resulting from a larger subscriber base and an increased consumer awareness of AOL. Marketing costs as a percentage of total revenues are anticipated to increase in fiscal 1997 over fiscal 1996. This increase is expected to be primarily attributable to an increase, in absolute dollars as well as a percentage of total revenues, in the amortization of deferred subscriber acquisition costs.

The Company experienced generally lower overall retention rates for the AOL service during fiscal 1996 compared to fiscal 1995. Retention rates for AOL subscribers who were early in their membership terms decreased more than the overall retention rate, with the largest quarterly percentage decrease occurring in the June 1996 quarter. The Company believes that factors contributing to these decreases include: (1) competition from an increasing number of service providers; (2) the availability of alternative pricing models from competitors, including unlimited use pricing; and (3) an increase in less-qualified new subscribers as a result of increased direct marketing to the mass consumer audience. The Company believes that the introduction in July 1996 of the Value Plan and the new version of AOL introduced in late fiscal 1996 address many of the factors which most directly affect retention. In addition, the Company plans to increase spending on programs designed to improve retention both as it relates to increasing trial conversion rates and reducing cancellations among longer-term users. Although the Company experienced somewhat higher monthly retention rates in July and August 1996, the Company cannot predict the overall future rate of retention.

The average total usage hours per member per month, for AOL subscribers, is expected to increase in fiscal 1997 over fiscal 1996. The Company believes that the principal factor contributing to this expected increase will be the availability of the Value Plan, which will allow members to spend more time online at less cost. Overall average monthly online service revenue per AOL subscriber in fiscal 1997 is expected to be comparable to fiscal 1996.

The online services and Internet markets are highly competitive. The Company believes that existing competitors, which include, among others, commercial online services such as CompuServe and Prodigy, Internet-based services, including, among others, the Microsoft Network, and Internet service providers, including various national and local independent Internet service providers as well as long distance and regional telephone companies, are likely to enhance their service offerings. In addition, new competitors, including Internet directory services and various media and telecommunication companies, have entered or announced plans to enter the online services and Internet markets, resulting in greater competition for the Company. The competitive environment could have the following effects: require additional pricing programs and increased spending on marketing, content procurement and product development; limit the Company's opportunities to enter into and/or renew agreements with content providers and distribution partners; limit the Company's ability to grow its subscriber base; and result in increased attrition in the Company's subscriber base. Any of the foregoing events could have an impact on revenues and result in an increase in costs as a percentage of revenues. These factors may have a material adverse effect on the Company's financial condition and operating results.

Results of Operations

Fiscal 1996 Compared to Fiscal 1995

Online Service Revenues For fiscal 1996, online service revenues increased from $344,309,000 to $991,656,000, or 188%, over fiscal 1995. This increase was primarily attributable to a 93% increase in the number of AOL subscribers. The percentage increase in online service revenues was greater than the percentage increase in AOL subscribers principally due to an increase in the average monthly online service revenue per AOL subscriber, which increased from $16.28 in fiscal 1995 to $17.96 in fiscal 1996.

Other Revenues Other revenues, consisting principally of the sale of merchandise, data network services, online transactions and advertising, marketing and production services and development and licensing fees, increased from $49,981,000 in fiscal 1995 to $102,198,000 in fiscal 1996. This increase is primarily attributable to an increase in the sale of merchandise, data network services and online transactions and advertising, partially offset by a decrease in revenues from marketing and productions services.

Cost of Revenues Cost of revenues includes network-related costs, consisting primarily of data and voice communication costs, costs associated with operating the data centers and providing customer support and royalties paid to information and service providers. For fiscal 1996, cost of revenues increased from $229,724,000 to $627,372,000, or 173%, over fiscal 1995, and decreased as a percentage of total revenues from 58.3% to 57.4%.

The increase in cost of revenues was primarily attributable to an increase in data communication costs, customer support costs and royalties paid to information and service providers. Data communication costs increased primarily as a result of the larger customer base and more usage by customers. Customer support costs, which include personnel and telephone costs associated with providing customer support, were higher as a result of the larger customer base and a large number of new subscriber registrations. Royalties paid to information and service providers increased as a result of a larger customer base, more usage and the Company's addition of more service content to broaden the appeal of the AOL service.

The decrease in cost of revenues as a percentage of total revenues is primarily attributable to a decrease in costs associated with marketing and production service revenues (as a percentage of total revenues) and a decrease in data communication costs resulting from lower variable costs per hour, due to a higher percentage of traffic generated on the Company's lower cost proprietary network, AOLnet. The aforementioned decrease was partially offset by increases in leased equipment costs, costs associated with providing data network services to third parties, costs of merchandise sold and royalties paid to information and service providers.

In late fiscal 1995, the Company launched AOLnet, a proprietary TCP/IP network that is owned and operated by the Company. The Company is building AOLnet in order to increase its network capacity, provide its members with more reliable, higher speed access, and reduce the costs of data communication. As the Company builds AOLnet, it is managing traffic to this network, and as of June 1996, approximately 65% of network traffic was carried on AOLnet. The buildout of AOLnet requires a substantial investment in telecommunications equipment, which the Company is financing primarily through leasing. As the size of AOLnet increases, and an increasingly higher percentage of overall network traffic is carried on AOLnet, it is expected that the Company's data communication costs will become more fixed in nature, rather than variable. The overall per hour cost of providing data communications is expected to decrease.

Marketing Marketing expenses include the costs to acquire and retain subscribers and other general marketing costs. The Company expenses the costs of advertising as incurred, except direct response advertising, which is classified as deferred subscriber acquisition costs. The deferred costs are amortized, beginning the month after such costs are incurred, over a period determined by calculating the ratio of current revenues related to direct response advertising versus the total expected revenues related to this advertising, or twenty-four months, whichever is shorter.

Effective July 1, 1995, the Company modified the components of subscriber acquisition costs deferred, and changed the period over which it amortizes subscriber acquisition costs. The period over which the Company amortizes subscriber acquisition costs was changed from twelve and eighteen months to the period described above in order to more appropriately match subscriber acquisition costs with associated online service revenues. For additional information regarding the accounting for deferred subscriber acquisition costs, refer to Note 2 of the Notes to Consolidated Financial Statements.

For fiscal 1996, marketing expenses increased from $77,064,000 to $212,710,000, or 176%, over fiscal 1995, and decreased as a percentage of total revenues from 19.5% to 19.4%. The increase in marketing expenses was primarily attributable to an increase in the size and number of marketing programs designed to expand the Company's subscriber base and new branding programs that began in August 1995.

Product Development Product development costs include research and development costs, other product development costs and the amortization of software costs. For fiscal 1996, product development costs increased from $14,263,000 to $53,817,000, or 277%, over fiscal 1995, and increased as a percentage of total revenues from 3.6% to 4.9%. The increases in product development costs, and such costs as a percentage of total revenues, were primarily attributable to an increase in personnel costs related to an increase in the number of technical employees. Product development costs, before capitalization and amortization, increased by 242%.

General and Administrative For fiscal 1996, general and administrative costs increased from $42,700,000 to $110,653,000, or 159%, over fiscal 1995, and decreased as a percentage of total revenues from 10.8% to 10.1%. The increase in general and administrative costs was primarily attributable to higher personnel, office and travel expenses related to an increase in the number of employees. The decrease in general and administrative costs as a percentage of total revenues was a result of the substantial growth in revenues, which more than offset the additional general and administrative costs, combined with the semi-variable nature of many of the general and administrative costs.

Acquired Research and Development Acquired research and development costs, totaling $16,981,000 in fiscal 1996, relate to in-process research and development purchased pursuant to the Company's acquisition of Ubique, Ltd. in September 1995. Acquired research and development costs, totaling $50,335,000 in fiscal 1995, relate to in-process research and development purchased pursuant to the Company's acquisitions of BookLink Technologies, Inc. ("Booklink") and Navisoft, Inc. ("Navisoft").

Amortization of Goodwill Amortization of goodwill increased to $7,078,000 in fiscal 1996 from $1,653,000 in fiscal 1995. The amortization of goodwill relates primarily to the Company's fiscal 1995 acquisitions of Advanced Network & Services, Inc. ("ANS") and Global Network Navigator, Inc., which resulted in approximately $56 million of goodwill. The goodwill related to these acquisitions is being amortized on a straight-line basis over periods ranging from five to ten years. The increase in amortization of goodwill results from a full year of goodwill being recognized in fiscal 1996 compared to only a partial year of goodwill being recognized in fiscal 1995.

Other Income (Expense) Other income (expense) consists primarily of interest expense and nonoperating charges net of investment income and nonoperating gains. The Company had other expense of $2,056,000 in fiscal 1996 and other income of $3,074,000 in fiscal 1995. The change in other income (expense) was primarily attributable to a charge in fiscal 1996 related to the settlement of a class action lawsuit, partially offset by an increase in investment income.

Merger Expenses Nonrecurring merger expenses totaling $848,000 were recognized in fiscal 1996 in connection with the merger of the Company with Johnson-Grace Company. Nonrecurring merger expenses totaling $2,207,000 were recognized in fiscal 1995 in connection with the mergers of the Company with Redgate Communications Corporation ("RCC"), Wide Area Information Servers, Inc. ("WAIS") and Medior, Inc. ("Medior").

Provision for Income Taxes The provision for income taxes was $32,523,000 and $15,169,000 in fiscal 1996 and fiscal 1995, respectively. For additional information regarding income taxes, refer to Note 8 of the Notes to Consolidated Financial Statements.

Net Income Net income in fiscal 1996 totaled $29,816,000. The net income in fiscal 1996 included charges of $16,981,000 for acquired research and development, $8,000,000 related to the settlement of a class action lawsuit and $848,000 for merger expenses.

Fiscal 1995 Compared to Fiscal 1994

Online Service Revenues For fiscal 1995, online service revenues increased from $98,497,000 to $344,309,000, or 250%, over fiscal 1994. This increase was primarily attributable to a 233% increase in the number of AOL subscribers. The percentage increase in online service revenues in fiscal 1995 was greater than the percentage increase in subscribers principally due to an increase in the average monthly online service revenue per subscriber, which increased from $14.50 in fiscal 1994 to $16.28 in fiscal 1995.

Other Revenues Other revenues, consisting principally of new media and interactive marketing services, data network services, multimedia and CD-ROM production services, and development and licensing fees, increased from $17,225,000 in fiscal 1994 to $49,981,000 in fiscal 1995. This increase was primarily attributable to data network revenues and multimedia and CD-ROM production service revenues from companies acquired during fiscal 1995.

Cost of Revenues For fiscal 1995, cost of revenues increased from $69,043,000 to $229,724,000, or 233%, over fiscal 1994, and decreased as a percentage of total revenues from 59.7% to 58.3%.

The increase in cost of revenues was primarily attributable to an increase in data communication costs, customer support costs and royalties paid to information and service providers. Data communication costs increased primarily as a result of the larger customer base and more usage by customers. Customer support costs, which include personnel and telephone costs associated with providing customer support, were higher as a result of the larger customer base and a large

number of new subscriber registrations. Royalties paid to information and service providers increased as a result of a larger customer base and more usage and the Company's addition of more service content to broaden the appeal of the America Online service.

The decrease in cost of revenues as a percentage of total revenues is primarily attributable to a decrease in expenses related to marketing services and personnel-related costs as a percentage of total revenues, partially offset by an increase in data communication costs as a percentage of total revenues, primarily resulting from an increase in higher baud speed usage at a higher variable rate as well as lower hourly pricing for online service revenue which became effective January 1, 1995.

Marketing For fiscal 1995, marketing expenses increased from $23,548,000 to $77,064,000, or 227%, over fiscal 1994, and decreased as a percentage of total revenues from 20.3% to 19.5%. The increase in marketing expenses was primarily due to an increase in the number and size of marketing programs to expand the Company's subscriber base. The decrease in marketing expenses as a percentage of total revenues is primarily attributable to a decrease as a percentage of total revenues in personnel-related costs.

Product Development For fiscal 1995, product development expenses increased from $5,288,000 to $14,263,000, or 170%, over fiscal 1994, and decreased as a percentage of total revenues from 4.6% to 3.6%. The increase in product development costs was primarily attributable to an increase in personnel costs related to an increase in the number of technical employees. The decrease in product development costs as a percentage of total revenues was principally a result of the substantial growth in revenues, which more than offset the additional product development costs. Product development costs, before capitalization and amortization, increased by 126% in fiscal 1995.

General and Administrative For fiscal 1995, general and administrative costs increased from $13,667,000 to $42,700,000, or 212%, over fiscal 1994, and decreased as a percentage of total revenues from 11.8% to 10.8%. The increase in general and administrative expenses was principally attributable to higher office and personnel expenses related to an increase in the number of employees. The decrease in general and administrative costs as a percentage of total revenues was a result of the substantial growth in revenues, which more than offset the additional general and administrative costs, combined with the semi-variable nature of many of the general and administrative costs.

Acquired Research and Development Acquired research and development costs, totaling $50,335,000 in fiscal 1995, relate to in-process research and development purchased pursuant to the Company's acquisitions of Booklink and Navisoft.

Amortization of Goodwill Amortization of goodwill relates to the Company's acquisition of ANS in fiscal 1995, which resulted in approximately $44 million in goodwill. The goodwill related to the ANS acquisition is being amortized on a straight-line basis over a ten-year period.

Other Income Other income consists primarily of investment and rental income net of interest expense. For fiscal 1995, other income increased from $1,810,000 to $3,074,000. This increase was primarily attributable to an increase in interest income generated by higher levels of cash available for investment, partially offset by a decrease in rental income and an increase in interest expense.

Merger Expenses Nonrecurring merger expenses totaling $2,207,000 were recognized in fiscal 1995 in connection with the mergers of the Company with RCC, WAIS and Medior. No merger expenses were incurred in fiscal 1994.

Provision for Income Taxes The provision for income taxes was $15,169,000 and $3,832,000 in fiscal 1995 and fiscal 1994, respectively. For additional information regarding income taxes, refer to Note 8 of the Notes to Consolidated Financial Statements.

Net Loss The net loss in fiscal 1995 totaled $35,751,000. The net loss in fiscal 1995 included charges of $50,335,000 for acquired research and development and $2,207,000 for merger expenses.

Liquidity and Capital Resources

The Company has financed its operations through cash generated from operations and the sale of its capital stock. The Company has financed its investments in facilities and telecommunications equipment principally through leasing. Net cash provided by (used in) operating activities was $1,421,000, $17,260,000 and $(66,727,000) for fiscal 1994, fiscal 1995 and fiscal 1996, respectively. Included in operating activities were expenditures for deferred subscriber acquisition costs of $37,424,000, $111,761,000 and $363,024,000 in fiscal 1994, fiscal 1995 and fiscal 1996, respectively.

Net cash used in investing activities was $41,993,000, $87,272,000 and $79,066,000 in fiscal 1994, fiscal 1995 and fiscal 1996, respectively.

In December 1993, the Company completed a public stock offering of 8,000,000 shares of common stock (adjusted for stock splits) which generated net cash proceeds of approximately $62.7 million.

In April 1995, the Company entered into a joint venture with Bertelsmann, AG ("Bertelsmann") to offer interactive online services in Europe. In connection with the agreement, the Company received approximately $54 million through the sale of approximately 5% of its common stock to Bertelsmann.

In October 1995, the Company completed a public stock offering of 4,963,266 shares of common stock (adjusted for a stock split) which generated net cash proceeds of approximately $139.5 million.

In May 1996, the Company entered into a joint venture with Mitsui & Co., Ltd. (Mitsui) and Nihon Keizai Shimbun, Inc. (Nikkei) to offer interactive online services in Japan. In connection with the agreement, the Company received approximately $28.0 million through the sale of convertible preferred stock to Mitsui. The preferred stock has an aggregate liquidation preference of approximately $28.0 million and accrues dividends at a rate of 4% per annum. Accrued dividends can be paid in the form of additional shares of preferred stock. During May 1998, the preferred stock, together with accrued but unpaid dividends, automatically converts into shares of common stock based on the fair market value of common stock at the time of conversion.

The Company leases the majority of its facilities and equipment under noncancelable operating leases, and as part of its network portfolio strategy is building AOLnet, its data communications network. The buildout of this network requires a substantial investment in telecommunications equipment, which the Company plans to finance principally through leasing. In addition, the Company has guaranteed minimum commitments under certain data and voice communication agreements. The Company's future lease commitments and guaranteed minimums are discussed in Note 5 of the Notes to Consolidated Financial Statements.

The Company uses its working capital to finance ongoing operations and to fund marketing and content programs and the development of its products and services. The Company plans to continue to invest aggressively in subscriber acquisition marketing and content programs to expand its subscriber base, as well as in computing and support infrastructure. Additionally, the Company expects to use a portion of its cash for the acquisition and subsequent funding of technologies, products or businesses complementary to the Company's current business. The Company anticipates that available cash and cash provided by operating activities will be sufficient to fund its operations for the next fiscal year.

Various legal proceedings have arisen against the Company in the ordinary course of business. In the opinion of management, these proceedings will not have a material effect on the financial position of the Company.

The Company believes that inflation has not had a material effect on its results of operations.

Seasonality

In April 1996, the Company began to see the effects of seasonality in both member acquisitions and in the amount of time spent by customers using its services. The Company may have experienced the effects of seasonality in previous periods, but the effects, if any, were not discernible due to the masking effect resulting from the Company's substantial growth rates in those periods. The Company expects that seasonality will have an effect in the future. Member acquisition is expected to be highest in the second and third fiscal quarters, when sales of new computers and computer software are highest due to the holiday season. Customer usage is expected to be lower in the summer months due largely to extended daylight hours and competing outdoor leisure activities.

Forward-Looking Statements

In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Company wishes to caution readers that the following important factors could cause the Company's actual results to differ materially from those projected in forward-looking statements made by, or on behalf of, the Company:

- Factors related to increased competition from existing and new competitors, including price reductions and increased spending on marketing and product development; limitations on the Company's opportunities to enter into and/or renew agreements with content providers and distribution partners; limitations on its ability to develop new products and services; limitations on its ability to continue to grow its

subscriber base; increased membership acquisition costs; lower average monthly revenue per subscriber and increased attrition in the Company's subscriber base.

• Risks related to the buildout of AOLnet, including the inability to expand server and network capacity at a rate sufficient to satisfy subscriber demands; the failure of any of the Company's network providers; the failure to obtain the necessary financing for the buildout of AOLnet; and the risk that demand will not develop for the capacity AOLnet will provide.

• Any damage or failure to the Company's computer equipment and the information stored in its data centers, such as damage by fire, power loss, telecommunications failures, unauthorized intrusions and other events, that causes interruptions in the Company's operations.

• The Company's inability to manage its growth and to adapt its administrative, operational and financial control systems to the needs of the expanded entity; and the failure of management to anticipate, respond to and manage changing business conditions.

• The failure of the Company or its partners to successfully market, sell and deliver its services in international markets; and risks inherent in doing business on an international level, such as laws governing content that differ greatly from those in the U.S., unexpected changes in regulatory requirements, political risks, export restrictions, export controls relating to encryption technology, tariffs and other trade barriers, fluctuations in currency exchange rates, issues regarding intellectual property and potentially adverse tax consequences.

• A moderating growth rate in the sale of new computers in the U.S. and, to some extent, internationally; general or specific economic conditions; the ability and willingness of purchasers to substitute other services for AOL; the perceived absolute or relative overall value of these services by the purchasers, including the features, quality and pricing compared to other competitive services; smaller market or slowing of market growth for such services.

• The amount and rate of growth in the Company's marketing and general and administrative expenses; the implementation of new marketing programs and promotional offers; the implementation of additional pricing programs; and the impact of unusual items resulting from the Company's ongoing evaluation of its business strategies, asset valuations and organizational structures.

• Difficulties or delays in the development, production, testing and marketing of products, including, but not limited to, a failure to ship new products and technologies when anticipated, including, but not limited to, new client software and new features and functionality, and the failure to develop new technology or modify existing technology to incorporate new standards and protocols.

• The acquisition of businesses, fixed assets and other assets and acquisition related risks, including successful integration and management of acquired technology, operations and personnel, the loss of key employees of the acquired companies, and diversion of management attention from other ongoing business concerns; the making or incurring of any expenditures and expenses, including, but not limited to, depreciation and significant charges for in-process research and development or other matters; and any revaluation of assets or related expenses.

• The ability of the Company to diversify its sources of revenue through the introduction of new products and services and through the development of new revenue sources, such as advertising, transactions and merchandise sales.

• The effects of, and changes in, trade, monetary and fiscal policies, laws and regulations, other activities of governments, agencies and similar organizations, and social and economic conditions, such as trade restrictions or prohibitions, inflation and monetary fluctuations, import and other charges, or federal, state, local and other taxes.

• The loss of the services of executive officers and other key employees; and the Company's continued ability to attract and retain highly skilled and qualified personnel.

• The costs and other effects of litigation, governmental investigations, legal and administrative cases and proceedings (whether civil, such as environmental and product-related, or criminal), settlements and investigations, claims, and changes in those items, and developments or assertions by or against the Company relating to intellectual property rights and intellectual property licenses.

• Adoptions of new, or changes in, accounting policies, practices and estimates and the application of such policies, practices and estimates.

• The effects of any activities of parties with which the Company has an agreement or understanding, including any issues affecting any investment or joint venture in which the Company has an investment; the amount, type and cost of the financing which the Company has, and any changes to that financing.

Consolidated Statements of Operations

(Amounts in thousands, except per share data)	Year ended June 30, 1996	1995	1994
Revenues:			
Online service revenues	**$ 991,656**	$ 344,309	$ 98,497
Other revenues	**102,198**	49,981	17,225
Total revenues	**1,093,854**	394,290	115,722
Costs and expenses:			
Cost of revenues	**627,372**	229,724	69,043
Marketing	**212,710**	77,064	23,548
Product development	**53,817**	14,263	5,288
General and administrative	**110,653**	42,700	13,667
Acquired research and development	**16,981**	50,335	–
Amortization of goodwill	**7,078**	1,653	–
Total costs and expenses	**1,028,611**	415,739	111,546
Income (loss) from operations	**65,243**	(21,449)	4,176
Other income (expense), net	**(2,056)**	3,074	1,810
Merger expenses	**(848)**	(2,207)	–
Income (loss) before provision for income taxes	**62,339**	(20,582)	5,986
Provision for income taxes	**(32,523)**	(15,169)	(3,832)
Net income (loss)	**$ 29,816**	$ (35,751)	$ 2,154
Earnings (loss) per share:			
Net income (loss)	**$ 0.28**	$ (0.51)	$ 0.03
Weighted average shares outstanding	**108,097**	69,550	69,035

See accompanying notes.

America Online, Inc.

Consolidated Balance Sheets

(Amounts in thousands, except share data)	June 30, 1996	1995
Assets		
Current assets:		
Cash and cash equivalents	**$118,421**	$ 45,877
Short-term investments	**10,712**	18,672
Trade accounts receivable	**42,939**	32,176
Other receivables	**29,674**	11,381
Prepaid expenses and other current assets	**68,832**	25,527
Total current assets	**270,578**	133,633
Property and equipment at cost, net	**101,277**	70,919
Other assets:		
Product development costs, net	**44,330**	18,949
Deferred subscriber acquisition costs, net	**314,181**	77,229
License rights, net	**4,947**	5,579
Other assets	**35,878**	9,121
Deferred income taxes	**135,872**	35,627
Goodwill, net	**51,691**	54,356
	$958,754	$405,413
Liabilities and Stockholders' Equity		
Current liabilities:		
Trade accounts payable	**$105,904**	$ 84,640
Other accrued expenses and liabilities	**127,898**	23,509
Deferred revenue	**37,950**	20,021
Accrued personnel costs	**15,719**	2,863
Current portion of long-term debt	**2,435**	2,329
Total current liabilities	**289,906**	133,362
Long-term liabilities:		
Notes payable	**19,306**	17,369
Deferred income taxes	**135,872**	35,627
Other liabilities	**1,168**	2,243
Total liabilities	**446,252**	188,601
Stockholders' equity:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized, 1,000 shares issued and outstanding at June 30, 1996	**1**	–
Common stock, \$.01 par value; 300,000,000 and 100,000,000 shares authorized, 92,626,000 and 76,728,268 shares issued and outstanding at June 30, 1996 and 1995, respectively	**926**	767
Additional paid-in capital	**519,342**	252,668
Accumulated deficit	**(7,767)**	(36,623)
Total stockholders' equity	**512,502**	216,812
	$958,754	$405,413

See accompanying notes.

Consolidated Statements of Changes in Stockholders' Equity

(Amounts in thousands, except share data)	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Total
Balances at June 30, 1993	–	–	49,562,136	$495	$ 26,992	$ (3,550)	$ 23,937
Common stock issued:							
Exercise of options and warrants	–	–	2,827,280	28	1,836	–	1,864
Sale of stock, net	–	–	10,713,760	107	66,149	–	66,256
Tax benefit related to stock options	–	–	–	–	4,590	–	4,590
Net income	–	–	–	–	–	2,154	2,154
Balances at June 30, 1994	–	–	63,103,176	630	99,567	(1,396)	98,801
Effect of immaterial poolings	–	–	2,062,756	21	1,032	524	1,577
Balances as Restated	–	–	65,165,932	651	100,599	(872)	100,378
Common stock issued:							
Exercise of options	–	–	2,905,256	29	4,655	–	4,684
Business acquisitions	–	–	4,785,354	48	75,653	–	75,701
Sale of stock, net	–	–	3,871,726	39	56,998	–	57,037
Tax benefit related to stock options	–	–	–	–	14,763	–	14,763
Net loss	–	–	–	–	–	(35,751)	(35,751)
Balances at June 30, 1995	–	–	76,728,268	767	252,668	(36,623)	216,812
Effect of pooling restatement	–	–	–	–	–	(960)	(960)
Balances as Restated	–	–	76,728,268	767	252,668	(37,583)	215,852
Common stock issued:							
Exercise of options and warrants	–	–	10,370,338	104	47,885	–	47,989
Business acquisitions	–	–	465,502	5	16,632	–	16,637
Sale of stock, net	–	–	5,061,892	50	141,320	–	141,370
Sale of preferred stock, net	1,000	$1	–	–	28,314	–	28,315
Tax benefit related to stock options	–	–	–	–	32,523	–	32,523
Net income	–	–	–	–	–	29,816	29,816
Balances at June 30, 1996	**1,000**	**$1**	**92,626,000**	**$926**	**$519,342**	**$(7,767)**	**$512,502**

See accompanying notes.

Consolidated Statements of Cash Flows

(Amounts in thousands)	Year ended June 30, 1996	1995	1994
Cash flows from operating activities:			
Net income (loss)	**$ 29,816**	$ (35,751)	$ 2,154
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Depreciation and amortization	**33,366**	12,266	2,822
Amortization of subscriber acquisition costs	**126,072**	60,924	17,922
Loss on sale of property and equipment	**44**	37	5
Charge for acquired research and development	**16,981**	50,335	–
Changes in assets and liabilities:			
Trade accounts receivable	**(10,435)**	(14,373)	(4,266)
Other receivables	**(18,293)**	(9,086)	(626)
Prepaid expenses and other current assets	**(43,305)**	(19,635)	(2,873)
Deferred subscriber acquisition costs	**(363,024)**	(111,761)	(37,424)
Other assets	**(26,938)**	(6,051)	(2,542)
Trade accounts payable	**21,150**	60,805	10,224
Accrued personnel costs	**12,856**	1,850	397
Other accrued expenses and liabilities	**104,531**	5,747	9,474
Deferred revenue	**17,929**	7,190	2,322
Deferred income taxes	**32,523**	14,763	3,832
Total adjustments	**(96,543)**	53,011	(733)
Net cash (used in) provided by operating activities	**(66,727)**	17,260	1,421
Cash flows from investing activities:			
Short-term investments	**7,960**	5,380	(18,947)
Purchase of property and equipment	**(50,262)**	(59,255)	(18,010)
Product development costs	**(32,631)**	(13,054)	(5,131)
Sale of property and equipment	**–**	180	95
Purchase costs of acquired businesses	**(4,133)**	(20,523)	–
Net cash used in investing activities	**(79,066)**	(87,272)	(41,993)
Cash flows from financing activities:			
Proceeds from issuance of common stock, net	**189,359**	61,721	68,120
Proceeds from issuance of preferred stock, net	**28,315**	–	–
Principal and accrued interest payments on line of credit and long-term debt	**(935)**	(3,045)	(7,795)
Proceeds from line of credit and issuance of long-term debt	**3,000**	13,488	14,260
Principal payments under capital lease obligations	**(1,402)**	(368)	(83)
Net cash provided by financing activities	**218,337**	71,796	74,502
Net increase in cash and cash equivalents	**72,544**	1,784	33,930
Cash and cash equivalents at beginning of period	**45,877**	44,093	10,163
Cash and cash equivalents at end of period	**$ 118,421**	$ 45,877	$ 44,093
Supplemental cash flow information			
Cash paid during the period for:			
Interest	**$ 1,659**	$ 1,076	$ 577
Income taxes	**–**	–	–

See accompanying notes.

Notes to Consolidated Financial Statements

Note 1: Organization

America Online, Inc. ("the Company") was incorporated in the State of Delaware in May 1985. The Company, based in Dulles, Virginia, is the leading provider of online services, offering its subscribers a wide variety of services, including electronic mail, conferencing, entertainment, software, computing support, interactive magazines and newspapers, and online classes, as well as easy and affordable access to services of the Internet. In addition, the Company is a provider of data network services and multimedia and CD-ROM production services.

Note 2: Summary of Significant Accounting Policies

Principles of Consolidation The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Business Combinations Business combinations which have been accounted for under the purchase method of accounting include the results of operations of the acquired business from the date of acquisition. Net assets of the companies acquired are recorded at their fair value to the Company at the date of acquisition.

Other business combinations have been accounted for under the pooling of interests method of accounting. In such cases, the assets, liabilities, and stockholders' equity of the acquired entities were combined with the Company's respective accounts at recorded values. Prior period financial statements have been restated to give effect to the merger unless the effect of the business combination is not material to the financial statements of the Company.

Revenue Recognition Online service revenues are recognized over the period services are provided. Other revenues, consisting principally of the sale of merchandise, data network services, online advertising and transactions, production services and development and licensing fees are recognized as services are rendered. Deferred revenue consists primarily of monthly subscription fees billed in advance, and prepaid network and advertising fees.

Property and Equipment Property and equipment are depreciated or amortized using the straight-line method over the estimated useful life of the asset, which ranges from 5 to 40 years, or over the life of the lease.

Deferred Subscriber Acquisition Costs The Company expenses the costs of advertising as incurred, except direct response advertising, which is classified as deferred subscriber acquisition costs. Direct response advertising consists solely of the costs of marketing programs which result in subscriber registrations without further effort required by the Company. These costs, which relate directly to subscriber solicitations, principally include the printing, production and shipping of starter kits and the costs of obtaining qualified prospects by various targeted direct marketing programs and from third parties. To date all deferred subscriber acquisition costs have been incurred for the solicitation of specifically identifiable prospects. No indirect costs are included in deferred subscriber acquisition costs.

The deferred costs are amortized, beginning the month after such costs are incurred, over a period determined by calculating the ratio of current revenues related to direct response advertising versus the total expected revenues related to this advertising, or twenty-four months, whichever is shorter. All other costs related to the acquisition of subscribers, as well as general marketing costs, are expensed as incurred.

On a quarterly basis, management reviews the estimated future operating results of the Company's subscriber base in order to evaluate the recoverability of deferred subscriber acquisition costs and the related amortization period. It is possible that management's future assessments of the recoverability and amortization period of deferred subscriber acquisition costs may change based upon actual results and other factors.

Effective July 1, 1995, the Company modified the components of subscriber acquisition costs deferred, and changed the period over which it amortizes subscriber acquisition costs. The period over which the Company amortizes subscriber acquisition costs was changed from twelve and eighteen months to the period described previously in order to more appropriately match subscriber acquisition costs with associated online service revenues. The effect of this change in accounting estimate for the year ended June 30, 1996, was to increase net income by $48,106,000 ($.45 per share).

Product Development Costs The Company capitalizes costs incurred for the production of computer software used in the sale of its services. Costs capitalized include direct labor and related overhead for software produced by the Company and the costs of software purchased from third parties. All costs in the software development process which are classified as research and development are expensed as incurred until technological feasibility has been established. Once technological feasibility has been established, such costs are capitalized until the software is commercially available. To the extent the Company retains the rights to software development funded by third parties, such costs are capitalized in accordance with the Company's normal accounting policies. Amortization is provided on a product-by-product basis, using the greater of the straight-line method or current year revenue as a percent of total revenue estimates for the related software product, not to exceed five years, commencing the month after the date of product release.

Product development costs consist of the following:

	Year ended June 30,	
(in thousands)	**1996**	1995
Balance, beginning of year	**$18,949**	$ 7,912
Costs capitalized	**32,631**	13,054
Costs amortized	**(7,250)**	(2,017)
Balance, end of year	**$44,330**	$18,949

The accumulated amortization of product development costs related to the production of computer software totaled $15,152,000 and $7,902,000 at June 30, 1996 and 1995, respectively.

Included in product development costs are research and development costs totaling $16,449,000, $5,277,000, and $2,453,000 and other product development costs totaling $30,118,000, $6,969,000, and $1,050,000 in the years ended June 30, 1996, 1995 and 1994, respectively.

Investments The Company has various investments, including foreign joint ventures, that are accounted for under the equity method of accounting. All investments in which the Company has the ability to exercise significant influence over the investee, but less than a controlling voting interest, are accounted for under the equity method of accounting. Under the equity method of accounting, the Company's share of the investee's earnings or loss is included in consolidated operating results. To date, the Company's basis and current commitments in its investments accounted for under the equity method of accounting have been minimal. As a result, these investments have not significantly impacted the Company's results of operations or its financial position.

All other investments, for which the Company does not have the ability to exercise significant influence and there is not a readily determinable market value, are accounted for under the cost method of accounting. Dividends and other distributions of earnings from investees, if any, are included in income when declared. The Company periodically evaluates the carrying value of its investments accounted for under the cost method of accounting and as of June 30, 1996, the fair value of these investments approximated cost.

Goodwill Goodwill consists of the excess of cost over the fair value of net assets acquired and certain other intangible assets relating to purchase transactions. Goodwill and intangible assets are amortized over periods ranging from 5-10 years. As of June 30, 1996 and 1995, accumulated amortization was $8,731,000 and $1,653,000, respectively. The Company periodically evaluates whether changes have occurred that would require revision of the remaining estimated useful life of the assigned goodwill or render the goodwill not recoverable. If such circumstances arise, the Company would use an estimate of the undiscounted value of expected future operating cash flows in relation to its determination whether the goodwill is recoverable. Based on its review, the Company does not believe that an impairment of its goodwill has occurred.

Cash, Cash Equivalents and Short-Term Investments The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. In fiscal 1995, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The adoption was not material to the Company's results of operations or its financial position. The Company has classified all debt and equity securities as available-for-sale. Available-for-sale securities are carried at fair value, with unrealized gains and losses reported as a separate component of stockholders' equity. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in other income. Available-for-sale securities at June 30, 1996 and 1995, consisted of U.S. Treasury Bills and other obligations of U.S. Government agencies totaling $4,080,000 and $7,579,000 and U.S. corporate debt obligations totaling $6,632,000 and $11,093,000, respectively. At June 30, 1996 and 1995, the estimated fair value of these securities approximated cost.

Net Income (Loss) per Common Share Net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common and, when dilutive, common equivalent shares outstanding during the period.

Reclassification Certain amounts in prior years' consolidated financial statements have been reclassified to conform to the current year presentation.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Recent Pronouncements In October 1995, the Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-Based Compensation," which is effective for the Company's June 30, 1997, financial statements. SFAS No. 123 allows companies to account for stock-based compensation under either the new provisions of SFAS No. 123 or under the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," with additional pro forma disclosures in the footnotes to the financial statements as if the measurement provisions of SFAS No. 123 had been adopted. The Company intends to continue accounting for its stock-based compensation in accordance with the provisions of APB No. 25. As such, the adoption of SFAS No. 123 will not impact the Company's results of operations or its financial position.

Note 3: Business Combinations

Pooling Transaction In February 1996, the Company completed its merger with Johnson-Grace Company ("Johnson-Grace"), in which Johnson-Grace became a wholly-owned subsidiary of the Company. The Company exchanged 1,617,778 shares of common stock for all the outstanding common and preferred stock of Johnson-Grace. Additionally, 72,429 shares of the Company's common stock were reserved for outstanding stock options issued by Johnson-Grace and assumed by the Company. The merger was accounted for under the pooling of interests method of accounting, and accordingly, the accompanying consolidated financial statements have been restated to include the accounts and operations of Johnson-Grace for all periods presented prior to the merger. In connection with the merger of the Company and Johnson-Grace, merger expenses of $848,000 were recognized during 1996.

Johnson-Grace had a fiscal year end of March 31 and, accordingly, the Company's retained earnings have been adjusted by $960,000 to reflect Johnson-Grace's results of operations for the three months ended June 30, 1995, which are not included in the Company's results of operations.

Johnson-Grace's revenues, adjusted for intercompany sales, during the nine months ended March 31, 1996, and the years ended June 30, 1995 and 1994, were minimal. During the nine months ended March 31, 1996, and the years ended June 30, 1995 and 1994, Johnson-Grace's net loss was $3,770,000, $2,104,000, and $396,000, respectively.

Purchase Transaction In September 1995, the Company acquired Ubique, Ltd. ("Ubique"), an Israeli company, in a transaction accounted for under the purchase method of accounting. A total of 388,532 shares of the Company's common stock were issued and $1,500,000 was paid in exchange for all of the outstanding equity and related rights of Ubique. Additionally, 43,896 shares of the Company's common

stock were reserved for outstanding stock options issued by Ubique and assumed by the Company. Approximately $17 million of the aggregate purchase price was allocated to in-process research and development and was charged to the Company's operations at the time of the acquisition.

Note 4: Property and Equipment

Property and equipment consist of the following:

(in thousands)	June 30, 1996	1995
Computer equipment	**$ 84,775**	$57,940
Buildings and related improvements	**34,479**	20,084
Land	**7,600**	6,075
Leasehold improvements	**6,068**	3,074
Furniture and fixtures	**5,701**	5,222
	138,623	92,395
Less accumulated depreciation and amortization	**37,346**	21,476
Net property and equipment	**$101,277**	$70,919

Note 5: Commitments and Contingencies

The Company leases facilities and equipment primarily under several long-term operating leases. Future minimum payments under noncancelable operating leases with initial terms of one year or more consist of the following:

(in thousands) Year ending June 30,	
1997	$ 72,264
1998	73,518
1999	57,123
2000	28,069
2001	11,266
Thereafter	50,998
	$293,238

The Company's rental expense under operating leases in the years ended June 30, 1996, 1995 and 1994, totaled approximately $47,844,000, $10,120,000 and $2,910,000, respectively.

Communication Networks The Company has guaranteed monthly usage levels of data and voice communications with one of its vendors. The remaining commitments are $192,000,000, $142,000,000 and $131,500,000 for the years ending June 30, 1997, 1998 and 1999, respectively. The related expense for the years ended June 30, 1996, 1995 and 1994, was $278,513,000, $138,793,000 and $40,315,000, respectively.

Contingencies Various legal proceedings have arisen against the Company in the ordinary course of business. In the opinion of management, these proceedings involve amounts which would not have a material effect on the financial position of the Company if such proceedings were disposed of unfavorably.

Note 6: Notes Payable

Notes payable at June 30, 1996, totaled approximately $20 million and consisted primarily of amounts borrowed to finance two office buildings and certain building improvements. The notes are collateralized by the respective assets. Two of the notes have a variable interest rate equal to 105 basis points and 100 basis points above the 30 day London Interbank Offered Rate. One of the notes has a fixed interest rate of 8.48% per annum. Aggregate maturities of notes payable for the years ended June 30, 1997, 1998, 1999, 2000, 2001, and thereafter are $1,029,000, $1,045,000, $1,062,000, $1,080,000, $1,100,000 and $15,021,000, respectively.

Note 7: Other Income

The following table summarizes the components of other income:

(in thousands)	Year ended June 30, 1996	1995	1994
Interest income	**$ 6,901**	$ 3,979	$1,658
Interest expense	**(1,404)**	(1,062)	(577)
Other income (expense)	**(7,553)**	157	729
	$(2,056)	$ 3,074	$1,810

Other income (expense) in the year ended June 30, 1996, includes an $8,000,000 charge related to the settlement of a class action lawsuit.

Note 8: Income Taxes

The provision for income taxes is attributable to:

(in thousands)	Year ended June 30, 1996	1995	1994
Income before provision for income taxes	**$32,523**	$15,169	$3,832
Current	**$ –**	$ –	$ –
Deferred	**32,523**	15,169	3,832
	$32,523	$15,169	$3,832

The provision for income taxes differs from the amount computed by applying the statutory federal income tax rate to income before provision for income taxes. The sources and tax effects of the differences are as follows:

(in thousands)	Year ended June 30, 1996	1995	1994
Income tax at the federal statutory rate of 34%	**$21,195**	$ (6,998)	$2,035
State income tax, net of federal benefit	**3,424**	1,597	403
Nondeductible charge for purchased research and development	**5,773**	17,114	–
Loss, for which no tax benefit was derived	**1,437**	2,347	1,394
Other	**694**	1,109	–
	$32,523	$15,169	$3,832

Deferred income taxes arise because of differences in the treatment of income and expense items for financial reporting and income tax purposes, primarily relating to deferred subscriber acquisition and product development costs.

As of June 30, 1996, the Company has net operating loss carryforwards of approximately $415,000,000 for tax purposes which will be available to offset future taxable income. If not used, these loss carryforwards will expire between 2001 and 2011. To the extent that net operating loss carryforwards, when realized, relate to stock option deductions, the resulting benefits will be credited to stockholders' equity.

The Company's income tax provision was computed based on the federal statutory rate and the average state statutory rates, net of the related federal benefit.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

(in thousands)	June 30, 1996	1995
Deferred tax liabilities:		
Capitalized software costs	**$ 16,801**	$ 7,008
Deferred member acquisition costs	**119,071**	28,619
Net deferred tax liabilities	**$135,872**	$35,627
Deferred tax assets:		
Net operating loss carryforwards	**$157,000**	$39,000
Total deferred tax assets	**157,000**	39,000
Valuation allowance for deferred assets	**(21,128)**	(3,373)
Net deferred tax assets	**$135,872**	$35,627

Note 9: Capital Accounts

Common Stock At June 30, 1996 and 1995, the Company's $.01 par value common stock authorized was 300,000,000 and 100,000,000 shares, respectively, with 92,626,000 and 76,728,268 shares issued and outstanding, respectively. At June 30, 1996, 37,783,810 shares were reserved for the exercise of issued and unissued common stock options and a warrant, and 478,813 shares were reserved for issuance in connection with the Company's Employee Stock Purchase Plan.

Preferred Stock In February 1992, the Company's stockholders approved an amendment and restatement of the certificate of incorporation which authorized the future issuance of 5,000,000 shares of preferred stock, $.01 par value, with rights and preferences to be determined by the Board of Directors.

During May 1996, the Company sold 1,000 shares of Series B convertible preferred stock ("the Preferred Stock") for approximately $28,000,000. The Preferred Stock has an aggregate liquidation preference of approximately $28,000,000 and accrues dividends at a rate of 4% per annum. Accrued dividends can be paid in the form of additional shares of Preferred Stock.

During May 1998, the Preferred Stock, plus accrued but unpaid dividends, automatically converts into shares of common stock based on the fair market value of common stock at the time of conversion.

Warrant In connection with an agreement with the Company's primary communications provider, the Company has an outstanding warrant, exercisable through March 31, 1999, subject to certain performance standards specified in the agreement, to purchase 3,600,000 shares of common stock at a price of $3.91 per share.

Shareholder Rights Plan During fiscal 1993, the Company adopted a shareholder rights plan and distributed a dividend of one preferred share purchase right (a "Right") for each outstanding share of the Company's common stock. The Rights become exercisable in certain limited circumstances involving a potential business combination or change of control transaction of the Company. Each Right initially entitles registered holders of the Company's common stock to purchase one one-hundredth of a share of the Company's new Series A Junior Participating Preferred Stock ("Series A Preferred Stock") at a price of $150.00 per one one-hundredth of a share of Series A Preferred Stock. Following certain other events after the Rights have become exercisable, each Right entitles its holder to purchase for $150.00 an amount of common stock of the Company or, in certain circumstances, securities of the acquirer, having a then-current market value of two times the exercise price of the Right. The Rights are redeemable for one cent per Right at the option of the Board of Directors. Until a Right is exercised, the holder of the Right, as such, has no rights as a shareholder of the Company. The Rights expire on May 3, 2003, unless redeemed prior to that date.

Stock Splits On November 25, 1994, April 27, 1995, and November 28, 1995, the Company effected two-for-one splits of the outstanding shares of common stock. Accordingly, all data shown in the accompanying consolidated financial statements and notes has been retroactively adjusted to reflect the stock splits.

Note 10: Stock Plans

Options to purchase the Company's common stock under various stock option plans have been granted to employees, directors and consultants of the Company at fair market value at the date of grant. Generally, the options become exercisable over periods ranging from one to four years and expire ten years from the date of grant. A summary of stock option activity is as follows:

	Number of shares	Option price per share
Balance at June 30, 1993	14,362,008	$ .06 - $ 4.59
Granted	2,917,200	$ 4.65 - $ 9.12
Exercised	(2,770,960)	$ .06 - $ 3.75
Forfeited	(218,800)	$ 1.12 - $ 9.00
Balance at June 30, 1994	14,289,448	$ .06 - $ 9.12
Granted	23,587,196	$ 6.95 - $22.00
Exercised	(2,677,232)	$ .06 - $ 9.12
Forfeited	(1,021,700)	$ .25 - $18.84
Balance at June 30, 1995	34,177,712	$ .06 - $22.00
Granted	4,605,995	$22.12 - $55.50
Exercised	(5,914,213)	$ .06 - $33.50
Forfeited	(2,155,078)	$ 1.12 - $54.25
Balance at June 30, 1996	30,714,416	$ .06 - $55.50

At June 30, 1996, 8,529,435 options were exercisable. There have been 17,356,437 options exercised under the above plans.

At June 30, 1996, the Company had 1,585,707 common stock options outstanding under stock option plans which were assumed by the Company in connection with various business combinations. The options are exercisable at prices ranging from $0.01 to $44.75 and vest over the next four years. At June 30, 1996, 505,375 options were exercisable.

Employee Stock Purchase Plan In May 1992, the Company's Board of Directors adopted an Employee Stock Purchase Plan ("the ESPP"). Under the ESPP, employees of the Company who elect to participate are granted options to purchase common stock at a 15 percent discount from the market value of such stock. The ESPP permits an enrolled employee to make contributions to purchase shares of common stock by having withheld from his or her salary an amount between 1 percent and 10 percent of compensation. The ESPP is administered by the Compensation Committee of the Board of Directors. The total

number of shares of common stock that may be issued pursuant to options granted under the ESPP is 800,000. A total of 321,187 shares of common stock has been issued under the ESPP.

Note 11: Employee Benefit Plan

Savings Plan The Company has a savings plan ("the Savings Plan") that qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating employees may defer a portion of their pretax earnings, up to the Internal Revenue Service annual contribution limit. The Company matches 50% of each employee's contributions up to a maximum matching contribution of 2% of the employee's earnings. The Company's matching contribution to the Savings Plan was approximately $1,126,000 and $358,000 in the years ended June 30, 1996 and 1995, respectively.

Note 12: Subsequent Event

In August 1996, the Company purchased 100% of the outstanding stock of The ImagiNation Network, Inc., an online games company. The Company paid $14.5 million in common stock in a transaction accounted for under the purchase method of accounting.

Quarterly Information (unaudited)

(Amounts in thousands, except per share data)	Quarter Ended September 30,	December 31,	March 31,	June 30,	Total
Fiscal 1996[1,3,4]					
Online service revenues	$178,479	$224,525	$285,481	$303,171	$ 991,656
Other revenues	19,423	24,620	26,859	31,296	102,198
Total revenues	197,902	249,145	312,340	334,467	1,093,854
Income (loss) from operations	(6,803)	14,994	24,720	32,332	65,243
Net Income (loss)	(10,907)	9,530	15,127	16,066	29,816
Net income (loss) per share	$ (0.14)	$ 0.09	$ 0.14	$ 0.14	$ 0.28
Fiscal 1995[1,2,3,4]					
Online service revenues	$ 48,688	$ 66,966	$ 95,391	$133,264	$ 344,309
Other revenues	8,248	9,429	13,713	18,628	50,018
Total revenues	56,936	76,395	109,104	151,892	394,327
Income (loss) from operations	4,202	(35,884)	(491)	10,175	(21,998)
Net Income (loss)	1,076	(39,339)	(3,296)	5,309	(36,250)
Net income (loss) per share	$ 0.01	$ (0.59)	$ (0.05)	$ 0.06	$ (0.52)

[1] Historical financial information for amounts previously reported in fiscal 1996 and 1995 have been adjusted to account for pooling of interests transactions.

[2] The sum of the quarterly financial information for fiscal 1995 does not agree to the Company's Consolidated Statement of Operations due to the pooling of interests restatement for Johnson-Grace Company, which combines Johnson-Grace's financial results with the Company's June 30 fiscal year end.

[3] The sum of per-share earnings (loss) does not equal earnings (loss) per share for the year due to equivalent share calculations which are impacted by the Company's loss in 1995 and by fluctuations in the Company's common stock market prices.

[4] Net income in the fiscal year ended June 30, 1996, includes charges of approximately $17.0 million for acquired research and development, $8.0 million for the settlement of a class action lawsuit, and $0.8 million for merger expenses. Net loss in the fiscal year ended June 30, 1995, includes charges of approximately $50.3 million for acquired research and development and $2.2 million for merger expenses.

Report of Independent Auditors

Board of Directors and Stockholders
America Online, Inc.

We have audited the accompanying consolidated balance sheets of America Online, Inc. as of June 30, 1996 and 1995, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended June 30, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of America Online, Inc. at June 30, 1996 and 1995, and the consolidated results of their operations and their cash flows for each of the three years in the period ended June 30, 1996, in conformity with generally accepted accounting principles.

Ernst + Young LLP

Vienna, Virginia
August 28, 1996

Stockholder Information

Market Price of Common Stock

The following table sets forth the range of high and low sale prices for the Company's common stock:

For the quarter ended:	High	Low
September 30, 1994	$10.28	$ 6.88
December 31, 1994	14.63	7.47
March 31, 1995	23.69	12.31
June 30, 1995	24.06	16.75
September 30, 1995	37.25	21.38
December 31, 1995	46.25	28.25
March 31, 1996	60.00	32.75
June 30, 1996	71.00	36.63

The Company has never declared, nor has it paid, any cash dividends on its Common Stock. The Company currently intends to retain its earnings to finance future growth and, therefore, does not anticipate paying any cash dividends on its Common Stock in the foreseeable future.

As of August 27, 1996, the approximate number of stockholders of record of Common Stock was 2,306.

Annual Meeting

The Annual Meeting of Stockholders will be held on Thursday, October 31, 1996, at 10 a.m., at the Hyatt Regency Reston, 1800 Presidents Street, Reston, Virginia.

Form 10-K

Copies of the Company's Annual Report on Form 10-K for the year ended June 30, 1996 (excluding the exhibits thereto) are available to beneficial owners of the Company's common stock without charge, upon request to the Secretary, America Online, Inc., 22000 AOL Way, Dulles, Virginia 20166.

Exchange Information

The Company's Common Stock is traded on the New York Stock Exchange under the symbol "AOL."

Options on the Company's stock are traded on the Chicago Board Options Exchange, the American Stock Exchange, and the Pacific Stock Exchange.

Independent Auditors

Ernst & Young LLP
Vienna, Virginia

Legal Counsel

Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.
Boston, Massachusetts

Transfer Agent and Registrar

The First National Bank of Boston
c/o Boston EquiServe Investor Relations
P.O. Box 644
Boston, Massachusetts 02102-0644

Directors and Officers

Executive Officers

Stephen M. Case
Chairman of the Board,
President, Chief Executive Officer and Director

David C. Cole
Senior Vice President;
President of AOL Enterprises

Michael M. Connors
Senior Vice President;
President of AOL Technologies

John L. Davies
Senior Vice President;
President of AOL International

Miles R. Gilburne
Senior Vice President, Corporate Development

Lennert J. Leader
Senior Vice President;
Chief Financial Officer

Theodore J. Leonsis
Senior Vice President;
President of AOL Services Company

Jean N. Villanueva
Vice President, Corporate Communications

Board of Directors

Stephen M. Case
Chairman of the Board,
President and Chief Executive Officer

Frank J. Caufield
General Partner, Kleiner, Perkins, Caufield & Byers

Robert J. Frankenberg
Former Chairman of the Board, President and Chief Executive Officer, Novell, Inc.

General Alexander M. Haig, Jr.
Chairman and President, Worldwide Associates, Inc.

James V. Kimsey
Chairman Emeritus

William N. Melton
President and Chief Executive Officer,
CyberCash, Inc.

Thomas Middelhoff
Member of Executive Board, Bertelsmann AG

Robert W. Pittman
Managing Partner and Chief Executive Officer,
Century 21 Real Estate Corporation

Scott C. Smith
President, Sun-Sentinel Company

Design: Broom & Broom, Inc., San Francisco

This Annual Report and the information contained on the enclosed CD-ROM contain forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Reference is made in particular to statements regarding anticipated growth in subscribers, growth in other revenues, the description of the Company's plans and objectives for future operations, assumptions underlying such plans and objectives and other forward-looking statements included in the Letter to Stockholders, "Delivering the best consumer experience," "Technology – keeping it simple, making the magic," "The number one brand in cyberspace," "The best in interactive programming only at AOL," "New business models at work," and "Management's Discussion and Analysis of Financial Condition and Results of Operations" (the "MD&A") in this Annual Report. Such statements are based on management's current expectations and are subject to a number of factors and uncertainties which could cause actual results to differ materially from those described in the forward-looking statements. In particular, careful consideration should be given to cautionary statements made in the MD&A, including under the heading "Forward-Looking Statements."

“goodbye.”

America Online, Inc. 22000 AOL Way Dulles, VA 20166 703/448-8700